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THE PENSION FUND DEBATE, a discussion paper prepared for and published by the Ontario Economic Council. Copies are available only at the Ontario Government Bookstore, 880 Bay Street, Toronto, Ontario M7A 1N8. Price: $1.00.

TORONTO, March 15 -- There is a serious inequity between public and private pensions, says a discussion paper issued today by the Ontario Economic Council.

The paper, The Pension Fund Debate is a reprint of two speeches presented to the Outlook and Issues seminar in London, November 28, 1977. R.M. MacIntosh, Executive Vice-President of the Bank of Nova Scotia, and J.F. Chalcraft, Assistant Professor of Economics at Brock University in St. Catharines, are the authors of the two papers.

Mr. MacIntosh stresses that "inequitable pension arrangements are only one of the inequitable consequences of inflation and the only lasting way to solve the problem will be to stamp out inflation altogether rather than attempt to index it." He points out that it is impossible in practice, as well as in law, to achieve full indexing in the same manner that is now available in the public sector.

Much of Mr. MacIntosh's remarks are devoted to a report issued by the Treasury Board of Canada defending the indexing of public pension. He condemns assumptions within the report by saying "the inflation rate was set too low, the rate of interest too high and the salary interest is assumed to be one percentage point less than the interest rate.

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"To state that the pension fund is actuarially sound based on these assumptions is not merely misleading but ludicrous. By assuming that the rate of return on the assets is higher than the rate of salary increase or the rate of inflation, the Treasury Board is in effect forcing the conclusion that the fund is actuarially sound," he says.

Mr. McIntosh points out the word "funded" is highly misleading with regard to public pension funds. "There is no fund, only a book entry, and there are no assets earning interest from which the pensions will be paid. The contributions from both employer and employee in the federal plan flow into the consolidated revenue fund, where they become merged with the general budget and non-budgetary expenditures and revenues of the government. The only fund is a liability on the part of the taxpayer."

In the private sector, however, there must be an actual pool of investment assets representing the contributions of employees and employers, which are managed by trustees or which are invested in an insured plan.

"The legal requirement under the Pension Benefits Standards Act is that the fund in this real meaning of the word must earn a sufficient rate to pay out the benefits to the retired members and current members of the pension fund in full. The rate of return on the assets can be actually measured, and if there is a deficiency in the plan it must be rectified over a given period of time," he says.

Mr. MacIntosh argues that all public service pension funds should flow through the market economy. "The point is that governments would have to borrow the money according to some criteria established by people representing the ultimate beneficiaries, so that there would be a market yardstick to measure the demand of government for savings.

"In fact this process already works to a significant degree in the Province of Ontario, and in the Province of Quebec we find this process at work, not only with respect to provincial superannuation accounts but with regard to the Quebec Pension Plan which is the counterpart of the Canada Pension Plan. It is this process which is lacking in the federal system, and which makes the Treasury Board's concept of a "funded plan so misleading," he stresses.

Mr MacIntosh suggests that the federal public service funds should be brought under the Canada Pension Benefits Standards Act. He argues that given the relatively large size of the public sector of the economy, public service pensions should be subjected to exactly the same arrangements as are applied to everyone else.

He also points out that the drying up of equity investment by pension funds and other important savings institutions is taking us down the road towards the end of the private enterprise. "Unless corporations can raise equity funds in the open market," Mr. MacIntosh says, "they will not be able to maintain the conventional financial ratios on which lenders base their loans. The ability of private corporations to borrow by issuing long term bonds will eventually be undermined by their inability to issue stock.

Mr. Chalcraft of Brock University says in his paper that both public and private pensions will continue to face rather difficult times. He says the outlook for private pensions is pessimistic. "Governments must revise regulations regarding the requirements of actuarial soundness that private plans must satisfy especially in periods of accelerating inflation.

"Those responsible for the management of the investment portfolios of pension funds, having now experienced a period of rapid inflation, must exhibit somewhat greater flexibility in investment strategy and invest

in those instruments such as variable rate mortgages, short-term bonds, gold and real estate, all of which tend to outperform the general equity market in periods of high and accelerating inflation."

"Governments must recognize that they cannot continue to expand expenditure programs in periods of slow economic growth without creating serious problems for the private sector, he says. This move, if continued, should help to reduce the rate of inflation and to make the problem of pension planning somewhat more manageable."

Mr. Chalcraft stresses that any move to liberalize vesting provisions will likely result in either a reduction in training programs offered by the employer with the resulting loss of income to the individual and the reduced level of output for society or the implementation of experienced-related fringe benefits which effectively achieve the same results as delayed vesting of pension benefits.

With regard to public pension programs, Mr. Charlcraft stresses that because of expected changes in age structure as well as the unfavourable economic forecasts, substantial modifications to the operation of these programs should be given immediate consideration.

"On the benefit side, however," Mr. Chalcraft says, "full indexation combined with the expected high rates of inflation will dramatically increase the outflow of funds over previously projected levels. Over the longer-term the rise in the proportion of female beneficiaries, who because of greater life expectancy will receive benefits for a longer period of time, will accelerate the outflow of pension benefits."

"If one accepts these demographic projections and economic forecasts then there is little alternative but to move immediately to establish funded public pension programs."

This discussion paper was prepared under the auspices of the Ontario Economic Council, an autonomous research agency funded by the Province of Ontario. The Council acts as an independent advisor to government and all political parties, undertakes research and policy studies to encourage the optimum development of the human and material resources of Ontario, and to support the advancement of all sectors of the Province. The Council achieves these goals by sponsorship of research projects, publication of studies, and organization of the Outlook and Issues conferences and seminars which are open to the public.

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